

DEPRECIATION WHEN

CANNOT BE TAKEN



DUE

ACTIVE YEAR - Must take
each year operating business

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
GRACE BROS. BREWING COMPANY)

Appearances:

For Appellant: Richard A. Coons, Certified
Public Accountant

For Respondent: James W. Hamilton, Senior Counsel
Lawrence Counts, Junior Counsel

OPINION

This appeal is made pursuant to section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protests of Grace Bros. Brewing Company against proposed assessments of additional franchise tax in the amounts of \$3,092.60, \$1,464.41, and \$1,396.04 for the years 1960, 1961, and 1962, respectively.

The first question for consideration is whether appellant was entitled to deduct depreciation allowances for certain brewery assets for the years 1960, 1961, and 1962.

Appellant is a domestic corporation engaged in the manufacture and distribution of beer. It also conducts a farming operation. It discontinued manufacture of beer in 1953, but resumed production in April 1958 when new markets were acquired for its product. Prior to 1953, appellant had established a plan of depreciation for certain of its brewery assets and had deducted amounts of depreciation therefor. For the period 1953-1958, it did not deduct any depreciation allowances for these assets. During this period it had no trade income from its brewery operation and sustained operating losses from its farming operation.

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Respondent maintains that the brewery assets were "used in the trade or business" of appellant and were fully depreciated prior to the year 1960 under the plan of depreciation adopted for the assets prior to 1953. It submits that no deductions for depreciation of these assets are allowable for the years 1960 through 1962.

Appellant contends that during the years 1953 through 1958 the brewery assets were not used in a trade or business because it was completely out of the brewery business and was holding the assets for sale. Therefore, it argues, no depreciation deductions were allowable during those years and the assets cannot be considered fully depreciated before 1960.

Section 24349 of the Revenue and Taxation Code provides:

(a) There shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)---

(1) Of property used in the trade or business; ...

Similar provisions of the United States Internal Revenue Code have frequently been construed by federal courts.

It is settled that a taxpayer must deduct a depreciation allowance for property used in his trade or business on his return for the year when the depreciation occurred and may not deduct it in a later year. (Hardwick Realty Co. v. Commissioner, 29 F.2d 498, cert. dismissed, 279 U.S. 876 [73 L. Ed. 1010].) The failure to make active use of business property does not prove the absence of depreciation. (Independent Brick Co., 11 B.T.A. 862.)

Property used in a trade or business includes all property "devoted to the trade or business" though no actual physical use is made of the property during a given year. (Kittredge v. Commissioner, 88 F.2d 632.) Mere idleness for protracted periods does not change the character of property previously established as business property. (Yellow Cab Co. v. Driscoll, 24 F. Supp. 993; Wilson Line, Inc., 8 T.C. 394; P. Dougherty Co. v. Commissioner, 159 F.2d 269.) Property once used in a business is regarded as remaining in such use until it is shown to have been withdrawn from business purposes. (Kittredge v. Commissioner, supra; Lorraine Corp., T.C. Memo., Dkt. No. 60461, July 21, 1958.)

The evidence offered by appellant consists of a showing of a period of nonoperation during which time the brewery assets were offered for sale. This is insufficient

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to support a finding that the assets were withdrawn from business purposes. A period of business inactivity followed by a sale of assets does not change the business character of the assets before the sale. (Solomon Wright, Jr., 9 T.C. 173; Carter-Colton Cigar Co., 9 T.C. 219; Alfred Kruse, 29 T.C. 463.) The business character of the assets is not changed, therefore, merely by offering them for sale.

The facts before us indicate that the assets were available for use and devoted to business purposes within the scope of the cases we have cited. Although there may have been a tentative plan to liquidate the business it was never consummated. When new markets were obtained for appellant's product, it resumed production and active use of the brewery assets. We find that the assets were not withdrawn from business purposes during the years 1953-1958, that they were subject to allowances for depreciation during those years, and that no further allowances may be taken during the years 1960-1962.

The remainder of this opinion concerns a bad debt deduction taken by appellant on its return for the year 1960. Respondent disallowed the deduction on the grounds that appellant failed to establish that the debt became wholly worthless during 1960.

During the years 1950 and 1951, Emil G. Biavaschi, a beer distributor, became indebted to appellant on an open trade account. In 1956, Biavaschi and his wife executed a demand note for the unpaid balance of the indebtedness, which totaled \$22,101.54. No payments were received on the note, and a renewal note was executed on April 18, 1960. At the time the renewal note was executed, Biavaschi advised appellant's attorney that he would discharge the obligation in bankruptcy if pressed for collection. Appellant's attorney ascertained that the debtor was employed on salary and owned an equity in his home. The attorney advised appellant in 1960 that "the chances of recovery on this note are not very good." The amount of the indebtedness was deducted in that year.

Section 24348 of the Revenue and Taxation Code permits a deduction for debts "which become worthless within the income year." This section is the counterpart of section 166 of the Internal Revenue Code of 1954.

Whether a debt has become worthless in a given year is to be determined by objective standards. (Redman v. Commissioner, 155 F.2d 319.) The actual financial condition of the debtor furnishes the primary test of worthlessness. (W. A. Dallmeyer, 14 T.C. 1282.) No deduction may be allowed for a particular year if the debt became worthless before or after that year. (Redman v. Commissioner, supra.) The taxpayer has the burden of proof. (Cittadini v. Commissioner, 139 F.2d 29.)

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It has not been established that the debt in question had value at the beginning of 1960. By that time the obligation was nine years old and no payments had been made on it. There is no evidence of the debtor's financial condition before 1960 such as would justify postponing the deduction.

Assuming that the debt did have value at the beginning of 1960, appellant has failed to establish that it became worthless in that year. The time of actual worthlessness must be evidenced by some event or substantial change in the debtor's financial condition which adversely affects his ability to make repayment. (H. W. Findley, 25 T.C. 311, aff'd, 236 F.2d 959.) An attorney's appraisal of the collectibility of a debt does not prove worthlessness unless supported by underlying facts. (Matthew Edwards, Sr., T.C. Memo., Dkt. No. 61950, July 21, 1959.) While a threat of bankruptcy indicates that the debtor would resist collection, it does not in itself show a change of financial position. Even an adjudication of bankruptcy, standing alone, may be insufficient to establish the date of worthlessness. (P. H. Gill & Sons Forge & Machine Works, 7 B.T.A. 1146; Taylor-Wharton Iron & Steel Co., 5 T.C. 768.) The record is completely barren of evidence of any change in the debtor's financial condition during 1960. We conclude that respondent did not err in disallowing the bad debt deduction for that year.

O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

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IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protests of Grace Bros. Brewing Company against proposed assessments of additional franchise tax in the amounts of \$3,092.60, \$1,464.41, and \$1,396.04 for the years 1960, 1961, and 1962, respectively, be and the same is hereby sustained.

Done at Pasadena, California, this 28th day of June, 1966, by the State Board of Equalization.

[Signature], Chairman
John W. Lynch, Member
[Signature], Member
_____, Member
_____, Member

ATTEST: [Signature], Acting Secretary